

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105**

**File No. RH02023855
Notice File No. Z-06-0328-03
Date: November 13, 2006**

Subject: Viatical Settlement Regulations

FINAL STATEMENT OF REASONS

UPDATE OF INFORMATIVE DIGEST

The information contained in the Commissioner's Informative Digest accompanying the initially noticed regulation is still accurate except as follows: the Summary of Existing Law, at page 4 erroneously refers to "section 10113.2(f) and (h)" as containing definitions of "viatical settlement broker" and "viatical settlement provider." The correct citations are to Proposed Sections 2548.2(f) and 2548.2(i) (the latter renumbered in the final version of the regulations from Section 2548.2(h).)

UPDATE OF INITIAL STATEMENT OF REASONS

On August 18, 2006, The California Department of Insurance made available for public inspection certain changes to the regulation text as originally proposed. The changes were sufficiently related to the rulemaking as originally noticed so that a reasonable member of the directly affected public could have determined from the original notice that these changes could have resulted. Thereafter, on October 12, 2006, the Department made available for public inspection a second amended version of the regulations and issued a Second Notice of Availability of Revised Text. As with the originally noticed version of the regulations, the second amended version issued on October 12 contained changes that were sufficiently related to the rulemaking as originally noticed such that a reasonable member of the directly affected public could have determined that these changes could have resulted. On October 18, 2006 a Corrected Second Notice of Revised Text was issued because the Department was informed that the last page of the Second Amended version of the regulations was inadvertently omitted. The comment period was extended and was closed November 2, 2006.

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The Table of Contents is the same as that that was originally noticed, except the word "viator" is stricken from the Title of Section 2548.4: "Designation of Third Party Contacts; Contacts with the Insured." This change was made in response to a commenter's statement that the viator and the insured are not necessarily the same person, and it is the insured that will be designating who may be contacted. In addition, the first reference to "Contacts" is now in the plural.

Section 2548.1

This section was revised to explain that the purpose of the regulation is not only to implement, but also to clarify Sections 10113.1 and 10113.2 of the Insurance Code. In addition, the Authority and Reference sections were revised to add Section 10113.1 as well as Section 10113.2. An explicit reference to Section 10113.2(f) was dropped, because the latter is contained in Insurance Code, Section 10113.2. These changes are necessary to make a clearer statement of the Department's authority and purpose in adopting these regulations. The "Authority and Reference" citations were modified throughout the regulation in the same fashion.

Section 2548.2(a)

The Commissioner made changes to the definition of "catastrophic or life threatening illness or condition," which defines what constitutes a viatical settlement regulated by the California Department of Insurance. The regulation originally noticed included a general qualifying criteria such as "an illness or condition that will result in a drastically limited life span not exceeding 24 months" followed more specific criteria including a medical condition that has required or requires extraordinary medical intervention; any condition that usually requires continuous confinement in a nursing home; or a medical condition that in the absence of extensive or extraordinary medical treatment would result in a drastically limited life span. (See Section 2548.2 (a) i. through iv. as originally noticed.) As noted by numerous commenting parties, however, this regulation required individuals, once they had a catastrophic medical condition to qualify indefinitely only for a viatical settlement, even though their medical condition had been successfully treated to the extent that the condition was no longer life threatening. After full consideration of all of the comments, the Commissioner agrees with the position of many commenters that the viatical settlement law, with its substantial protections, was intended to protect those individuals who as a consequence of their grave health, would be considered particularly vulnerable to exploitative practices. The Commissioner agrees, however, that it is not appropriate to regulate life settlements by having an unduly broad definition of what constitutes a catastrophic or life threatening illness or condition, particularly in those instances where a once grave condition has responded favorably to medical treatment.

For the above reasons, revised Section 2548.2(a) now creates a presumption that all of the conditions referenced in the originally noticed regulations do constitute a "catastrophic or life threatening illness or condition." However, the presumption can be rebutted if a licensed physician or independent medical underwriter certifies that the insured has a life expectancy in excess of 24 months. The Commissioner believes that this change is reasonably necessary to avoid interpreting what constitutes a viatical settlement in an needlessly broad fashion, thereby potentially intruding upon California's life settlement business; while at the same time affording all of the protections of the viatical regulatory framework for those who are truly vulnerable.

Section 2548.2(b)

The Commissioner made only a very minor, nonsubstantive revision to Section 2548.2(b) by changing a reference within this section to 2548.2(h) to 2548.2(i). This renumbering was required to accommodate the change in numbering due to the addition of Section 2548.2(g).

Section 2548.2(c)

The Commissioner made only one minor, nonsubstantive change to this provision, by capitalizing the word, “commissioner.” This change was in response to a comment, and was necessary to make the regulations consistent.

Section 2548.2(e)

The Commissioner revised the organization of this section by stating that a viatical settlement means an agreement entered into between a viatical settlement provider and viator, and then, rather than containing a wordy definition, it refers to Sections 2548.2(i) and (j), which define the words, “viatical settlement provider” and “viator.” This change was made in response to a suggestion from a commenter, and the Commissioner agrees that this change results in a clearer, simpler definition of “viatical settlement.” In addition, the Commissioner added the word “viatical settlement agreement” to clarify that the two phrases can be used interchangeably. Finally, the Commissioner added the word, “insurance” to “policy” as it is more accurate to refer to a “life insurance policy” as opposed to simply a “life policy.” All of these changes are reasonably necessary to enhance the clarity of these regulations.

Section 2548.2(f)

The Commissioner slightly rephrased sentence two to clarify that a viatical settlement broker is deemed to represent only the viator and not the insurer or viatical settlement provider. The Commissioner added clarifying language explaining that the latter principle applies regardless of how or by whom a viatical settlement broker is compensated. There was also added a slight rephrasing of the sentence stating the licensure requirement for viatical settlement brokers. In addition, after reviewing a comment from the California Department of Corporations, the Commissioner believed it to be prudent to insert clarifying language that the requirements of Section 2548.2(f) were in addition to any other requirements provided by the Corporate Securities Law of 1968. Finally, at the suggestion of a commenter, the Commissioner slightly rephrased section 2548.2(f)(2) while preserving its substance. All of these changes are reasonably necessary to clarify the regulations.

Section 2548.2(g)

In response to a commenter, the Commissioner inserted a definition of “viatical settlement investment,” defining such as any legal or beneficial interest in a viatical settlement offered to a purchaser other than to a licensed viatical settlement provider. Language was also inserted, at

the suggestion of the California Department of Corporations, clarifying that the definition was in *addition* to any imposed by the Corporate Securities Law of 1968, the latter law being implemented by the California Department of Corporations. The addition of this language is reasonably necessary for purposes of clarifying the regulations, so that those individuals marketing investments in viatical settlements are aware that there are licensing requirements imposed by both the California Department of Insurance and the California Department of Corporations.

Section 2548.2, Subdivision(h)

This section, now renumbered from Section 2548.2(g) to 2548.2(h), contains a slight rephrasing of the requirement that one performing certain activities must be licensed as a viatical settlement investment broker. In addition, at the suggestion of the California Department of Corporations, the regulation now states that the requirements of this rule are in addition to any other requirements provided by the Corporate Securities Law of 1968. Finally, the Commissioner added the word “investment” in the last line of Section 2548.2(h) These changes are necessary to enhance the clarity of this provision. In addition, the reference to the Corporate Securities Law of 1968 makes clear that the Department of Insurance’s requirements are separate from those contained in the Corporate Securities Law of 1968.

Section 2548.2, Subdivision (i)

This section, now renumbered from former Section 2548.2(h), has been modified to clarify that a provider enters into a transaction with a viator. In addition, there has been a minor change to improve readability by omitting the use of the word, “viaticated” and substituting the phrase, “which is the subject of a viatical settlement.” Also, per the suggestion of a commenter, the Commissioner has inserted the statement that “the requirements of this rule are in addition to any other requirements provided by the Corporate Securities Act of 1968. The latter change is reasonably necessary to clarify that the Insurance Commissioner’s definition of viatical settlement is in addition to that contained in the California Corporations Code; it is not intended to supplant it.

In addition, Section 2548.2(i)(1) contains a change in that what is *not* included from the definition of viatical settlement provider. Namely, a bank, savings and loan, etc., that takes an assignment of a life insurance policy solely as collateral for a loan, and not as part of any transaction or agreement defined as a life settlement is excluded from the definition of viatical settlement provider. This exclusion is reasonably necessary to prevent investors from soliciting life insurance policies solely for the purpose of having them assigned for value to the investors. While such “manufactured life insurance” is likely to be very rare in the viatical settlement context, since individuals ill enough to meet the definition of a viator would be encounter great difficulty in finding an insurance company to underwrite their policy, this language has been inserted at the suggestion of a commenter to act as an absolute barrier against such practices. The latter are highly disfavored by the Commissioner because they likely violate the insurable interest provisions of the California Insurance Code. (See Insurance Code, Sections 10110 et seq.) Finally Section 2548.2(i)(3) has been modified to include a minor grammatical correction.

Section 2548.2(j)

This section, now renumbered from Section 2548.2(i) to Section 2548.2(j), has been changed to require a viator to be a person who is a resident of the state of California owing a life insurance policy. After careful review of the comments, the Commissioner deemed this change to be appropriate to avoid having a viatical settlement provider whose operations were located in California to be subject to conflicting state laws where the viator was an out of state resident. The Commissioner agrees with the commenters that it should be the viator's state of residence that should control the law applying to the transaction; thus, the insertion of this qualifying language was to avoid the regulation having an extraterritorial reach to transactions involving out of state viators.

In addition, the Commissioner accepted one commenter's suggestion of deleting the word "original" to define "certificate holder." The Commissioner agrees with the commenter's rationale that deleting the word "original" eliminates the prospect of California residents transferring their insurance policies to other individuals who would, as subsequent owners, engage in transactions which would be viatical settlements, but would technically fall outside the definition.

These changes are reasonably necessary to clarify the regulations, and to avoid having California laws extending an extraterritorial reach.

Section 2548.3

This section has been slightly modified to clarify, consistent with Sections 2548.2(f), 2548.2(g), and 2548.2(h) that the requirements of Section 2548.3 are in addition to any other requirements imposed by the Corporate Securities Law of 1968. This section is reasonably necessary to clarify that the Commissioner, in adopting these regulations, does not intend in any way to intrude upon the separate jurisdiction of the California Department of Corporations. The section is necessary to clarify that licensees have to comply with both requirements of the California Department of Insurance and the California Department of Corporations.

Section 2548.4

Beginning with the title, the Commissioner has changed Section 2548.4 to be more accurate and read better, but the changes are largely nonsubstantive. The caption has been modified to drop the reference to "Viator" because, as was clarified by a commenter, the viator and the insured are not necessarily the same individual, and it is the insured who designates a third party to contact concerning the insured's health status. This section has also been generally modified, at the suggestion of a commenter, to improve its readability. These changes are all reasonably necessary to improve the readability and accuracy of the regulations.

Section 2548.5

The disclosure requirements have been modified in the following ways. First of all, Section 2548.5 now clarifies that it is either the viatical settlement provider or the broker who makes a series of disclosures. Moreover, if the broker satisfies the disclosure requirements, then the provider is deemed to have also done so, as long as the provider maintains a copy of the written disclosures. The purpose of this is to allow flexibility as to whom (as between the broker and the provider) will make the disclosures, as long as they are made, and there is verification that they were made. Also, Section 2548.5(4) contains a minor change in clarifying that it is the insured, as opposed to viator, that is the appropriate party to designate the recipient of inquiries regarding the insured's health status. In addition, Section 2548.5(6) now provides that estimates of the life expectancy of the insured must be disclosed unless to do so would violate California or federal privacy laws. This change was made in response to a suggestion of a commenter because it could be a potential violation of privacy laws to give life expectancy determinations to the viator where the viator and the insured are not the same individual, unless the insured has waived the protection of such laws to the viatical settlement licensee for this limited purpose. These changes are all reasonably necessary to improve the clarity and the readability of the regulations.

Section 2548.6

This section has been modified to clarify that the transfer (via a viatical settlement) of a legal or beneficial interest in a life insurance policy will trigger the requirement that funds to be received by the viator must be held in an escrow account. The section now clarifies that not only the attorney, but the law firm representing the provider are not allowed to also function as the provider's escrow agent. In addition, at the suggestion of a commenter, proceeds deposited to the escrow account shall be transferred to the viator within 3 business days, as opposed to 15 calendar days following the provider's receipt of acknowledgement of transfer of ownership of or beneficial rights to the insurance policy. In addition, there were minor changes in the phrasing of this section to improve the readability. These changes are all reasonably necessary to improve the clarity and readability of this provision, as well as to not require the viator to wait an unreasonably long period of time for receipt of proceeds from the transaction.

Section 2548.7

Section 2548.7(a) has been slightly changed to improve readability of the regulation. Section 2548.7(b) clarifies that a licensee cannot enter into any viatical settlement where payments to *the viator* are to be made in installments. Section 2548.7(d) has been modified to delete the phrase, "on the policy," as this language is superfluous. Section 2548.7(e) has been modified to clarify that the Commissioner's authorization for a licensee to act as in the capacity of both a viatical settlement broker and provider must be provided *in advance*, and *in writing*. Furthermore, Section 2548.7(f) has been modified to state that a viatical settlement broker cannot act as a broker in a viatical settlement after having acted as the original producing agent with respect to the same policy, unless written disclosure of this potential conflict of interest is provided to the viator.. These changes are all reasonably necessary to improve the clarity of the regulations, and to either seek commissioner authorization or disclose potential conflicts of interest in those areas of the regulation where potential conflicts of interest have been identified. (See Sections 2548.7 (e) and (f).)

Section 2548.8

The introductory sentence to Section 2548.8 has been slightly modified to add further clarifying language to “broker” and to delete a reference to “sales agent” and replace it with “viatical settlement investment broker.” In addition, Section 2548.8(f) has been modified to clarify that it is grounds for revocation where the licensee/applicant does business with an unlicensed applicant or individual only if licensing for the capacity in which the person acts is required. In addition Section 2548.8(h) now states as a grounds for discipline where the provider has failed “to establish or maintain” as opposed to “set up” an escrow account. Finally, Section 2548.8(m) includes a nonsubstantive rephrasing to improve its readability. All of these changes are reasonably necessary to clarify and regulations.

UPDATE OF MATERIAL RELIED UPON

No material other than that presented in the Initial Statement of Reasons has been relied upon by the Commissioner.

MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The Commissioner has determined that adoption, amendment or repeal of the regulation does not impose a mandate on local agencies or school districts. The regulation does not involve local agencies or school districts; it neither requires nor prohibits action on their part.

ALTERNATIVES

The Commissioner has determined that that no alternative would be more effective in carrying out the purpose for which the regulation is proposed, or would be as effective and less burdensome to affected private persons than the proposed regulation. Moreover, several of the sections that were deemed to be burdensome as originally noticed, namely Proposed Sections 2548.2(a) and 2548.2(j), have been modified to address commenter concerns regarding the arguably unreasonably broad definition of “catastrophic and life threatening” as well as the potential extraterritorial reach of the proposed regulations. These modifications should substantially reduce any burdensome impact of the regulations. Furthermore, no alternative to the regulation was raised by the commenters; other than to postpone adopting the regulation for further study of the industry. The Commissioner, however, does not find this to be a reasonable or productive alternative. Because no conceivable alternative regulation would be less burdensome to affected private persons without necessarily hampering the effective implementation and clarification of Insurance Code, Sections 10113.1 and 10113.2, the Commissioner proposes this regulation for adoption.

SUMMARY OF AND RESPONSES TO OBJECTIONS OR RECOMMENDATIONS

A summary of each written and oral comment, objection and/or recommendation received during the public comment period and responses to each are attached hereto as follows: a Summary of Comments Submitted During the 45-Day Comment Period are Attached hereto as Appendix 1; a

Summary of Comments at June 9, 2006 Hearing are attached hereto as Appendix 2; A Summary of Comments Submitted in Response to First 15-Day Comment Period are attached hereto as Appendix 3, and a Summary of Comments Submitted in Response to Second 15-Day Comment Period are attached hereto as Appendix 4.